

Extended Enterprise Relationships: Do You Know Your Risks?

As the global recession began to take hold during 2008, Chief Audit Executives (CAEs) started seeing a change in their stakeholders' expectations. As the economy softened, cost-cutting became the order of the day for most organizations. Accordingly, Internal Audit was asked to take on a more direct roll in assisting management through the identification and pursuit of cost recovery and savings opportunities.

In response to these pressures, the Institute of Internal Auditors (IIA) and its Research Institute conducted a member survey in February, 2009. The survey's primary objective was to determine how Internal Audit activities were being affected by the economic downturn. Not surprisingly, the survey revealed that the performance of contract (Extended Enterprise) audits, to help assure vendor compliance, was one of stakeholders' top five requests for assistance. This recognition was further supported during roundtable discussions held at the 2009 General Audit Management conference as well as at other professional gatherings held during the first half of the year.

Aware that many of its member organizations, having recently developed and devoted a large portion of their resources to Sarbanes-Oxley and other compliance-related risks, no longer possessed the skill sets and experience to undertake these types of audits, the IIA published an International Professional Practice Framework - Practice Guide titled "Auditing External Business Relationships." This was a clear message that the profession was reacting to this change in stakeholder expectations and anticipating the need for experienced resources and guidance to deal with the new focus of adding value through cost recovery and tighter monitoring of controls around vendor relationships.

The concept of partnering or aligning an organization with one or more other businesses is always a management consideration as organizations strive for the lowest possible cost in producing goods or services. Along with cost reduction, other benefits such as improved quality of service, timely completion, improved access to (and knowledge of) markets also accrue from these relationships. With each vendor or Extended Enterprise Relationship (EER), however, come risks that are oftentimes overlooked as management believes that the relationship itself has somehow mitigated all risk. As a result, Internal Audit plays a critical role in highlighting risks within vendor selection, contract effectiveness, contract management, contract compliance (monitoring and reporting) and identifying conflicts of interest.

Initially, Internal Audit must define the full inventory of EERs that currently exist within the organization. Once this list has been prepared, a further understanding of the relationships and resulting risks should be undertaken. The following questions should be considered:

- Why was the relationship initiated?
- How was the contract and relationship defined and what are the parties' expectations?
- How does the procurement process work?
- How is the continuing relationship overseen by management?
- How is objectivity and independence maintained?
- What specific controls have been established to monitor adherence to the terms of the contract?

The answers to these and other questions should be used to develop an EER risk assessment model that is incorporated into Internal Audit's annual audit universe. The likely result will be the addition of significant EERs as auditable units that can be specifically considered in the overall risk assessment process. Subsequently, EERs are embedded in audit planning with cost recovery audits being executed in conjunction with traditional internal audits. Typically, the following areas are initially identified as key areas of audit interest:

- Service Level Agreement compliance
- Quality assurance processes
- Invoicing processing process
- Regulatory compliance
- Data integrity and security
- Transition or disaster recovery plans

It is important to understand that EER audits are unique. They are usually conducted externally and can require niche expertise as well as negotiating skills. Additionally, it is critical that your team has the appropriate credentials to assess, identify and quantify key EER subject matter areas to ensure appropriate execution.

As your EER program matures, Internal Audit will increasingly be viewed as a true business partner and will help drive performance. These contributions are further leveraged to provide a more comprehensive assessment of risk and corresponding controls evaluation throughout the organization. When integrated effectively with traditional audit planning and execution, EER auditing will make both your function and your organization more effective.